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SUBJECT: EEB A/S FERNANDEZ AND LOBO TEAM DISCUSS ECONOMIC
CHALLENGES

REF: TEGUCIGALPA 0099

¶1. (SBU) Summary: Assistant Secretary for Economic, Energy, and Business Affairs Jose Fernandez met with members of the new Honduran government's economic team on January 26, the day before the inauguration of President Lobo. Among the participants were William Chong Wong, who was subsequently named Minister of Finance for the new government, and Maria Elena Mondragon, who will head the central bank. A/S Fernandez emphasized the importance of the Pathways to Prosperity initiative and encouraged Honduras, which chairs the Pathways pillar on small and medium enterprises, to be prepared to play a strong role at the Pathways ministerial in San Jose. The economic team expressed interest in learning more about Pathways. A/S Fernandez said that he hoped to work with the economic team on areas of common interest, including channeling remittances into investment, increasing agricultural productivity, and public-private partnerships. The economic team expressed concern about the government's balance sheet, particularly the large amount of short-term internal debt, and pressed for resumption of economic assistance, including budget support and technical assistance. Mondragon said that discussions on renewing World Bank funding are already underway. Embassy hopes that the Department will be able to provide TDY support to get the new economic team up to speed on Pathways. End summary.

¶2. (U) Assistant Secretary Fernandez met with members of President Porfirio "Pepe" Lobo's economic team on January 26. The following day, President Lobo was inaugurated and several participants in the meeting joined the cabinet. Honduran participants in the meeting included William Chong Wong, who was appointed Minister of Finance, Maria Elena Mondragon, who was named central bank president, Marlon Tabora, who will serve as deputy to Maria Antonieta Bogran in the Office of the Presidency, Jose Oswaldo Guillen, who will head the tax revenue service, and Camilo Atala, a prominent businessman who has served as an economic advisor to the Lobo team. (Biographic information on Wong, Mondragon, and Tabora is available in refTel.) Economic counselor Mary Grace McGeehan, USAID Director William Brands, and Millennium Challenge Corporation Director Jonathan Brooks also took part in the meeting.

¶3. (SBU) Assistant Secretary Fernandez told the economic team that he is very interested in finding ways for the U.S. and Honduran governments to work together to raise the living

standards of Honduras's poor. He noted that it will take time for the U.S. to fully reengage with Honduras, but said it is not too early to start making plans. A/S Fernandez said that he had read about the economic plan in Lobo's campaign platform and that many of its elements, including improving agricultural production, public-private partnerships, and finding ways for family remittances to be generated into investment, are of special interest to him as well.

¶4. (U) Fernandez told the team that he has been very much involved in planning for the Pathways to Prosperity Ministerial, which will take place in San Jose in early March. He told the economic team that he hoped that the new government would make Pathways an early priority. (Note: Honduras chairs the first Pathways pillar on small, medium, and microenterprise. End note.) Mondragon and the other team members expressed interest in learning more about Pathways.

¶5. (SBU) Atala told A/S Fernandez that members of the economic team had recently returned from Washington, where they had met with representatives of the Interamerican Development Bank (IDB), World Bank, and International Monetary Foundation (IMF). He provided an overview of the economic troubles Honduras has faced recently, including an 8 percent decline in remittances and a 25 percent decline in the textile industry. He noted that the country was facing difficult challenges even before the June 28 coup d'etat that removed President Manuel "Mel" Zelaya from power. These included the global economic downturn, the H1N1 influenza epidemic, and the May 28 earthquake that did significant

damage in San Pedro Sula, Honduras's industrial center. After June 28, new investment stopped. Atala told A/S Fernandez that, because of this situation, combined with excessive spending by the Zelaya government, the new government will face a considerable fiscal deficit. Mondragon said that internal and external debt total 25 percent of the country's GDP and noted that an excessively high percentage of this is short-term domestic debt. Atala told A/S Fernandez that the role of the U.S. will be very important as Honduras moves to reengage with the international financial institutions.

¶6. (SBU) Asked by A/S Fernandez about tax collection, Chong Wong said that it has gone down, adding that the 2009 budget had underestimated expenditures and will have to be revised. (Note: The Zelaya government failed to pass a 2009 budget, and the de facto government hastily put together a budget based on the 2008 budget. The Zelaya government's off-the-books expenditures are still being reconciled. End note.) Mondragon noted that international isolation during the political crisis had complicated matters; for example, the IMF had denied the de facto government access to Honduras's allotment of special drawing rights issued to member states in August 2009. This, combined with a lack of budget support over the last two years, has, she said, created a grave situation. (Note: Discussions on the renewal of the IMF stand-by arrangement for Honduras broke down in early 2009 due to the Zelaya government's unwillingness to either devalue the country's currency or make budget cuts. End note.) Mondragon said that, although it has been widely reported that Honduras will not be eligible for lending from the World Bank and IDB until the country negotiates a new stand-by arrangement with the IMF, this is not in fact the case. She told A/S Fernandez that resumption of budget support from the World Bank could take place through a less formal mechanism, and that discussions on this were underway. Mondragon said she also hoped the Treasury Department's technical assistance program could be restarted as soon as possible. She commented that reactivating the economy is not only important in terms of economic well-being, it is also the key to avoiding another political crisis.

¶7. (SBU) A/S Fernandez said that channeling some remittances toward investment rather than consumption is a promising possibility. He noted that studies show that five

to ten percent of remittances are typically available for investment. Ideally, the investment funds would be used for infrastructure projects, but remittance recipients typically do not have the experience to carry out such projects. Atala said that, when remittances are used for investment, this is usually for housing. He noted that the housing sector has experienced a severe contraction during the crisis and said that the new government hopes to revive it.

¶8. (SBU) Atala noted that energy, and particularly renewable energy, will be another government priority. He told A/S Fernandez that energy generation in Honduras is currently 78 percent non-renewable and 22 percent renewable. The new government will aim to raise the proportion of renewable energy generation to 50 percent and eventually above. Many new renewable energy projects will be public-private partnerships. He said that dam construction has the potential to generate not only energy but also employment, for example through tilapia farming.

¶9. (SBU) Mondragon told A/S Fernandez that the incoming government plans to put in place a conditional cash transfer program for families, to improve the educational system, and tackle the poor security situation. Without improvements in security, she said, it will be difficult to create a positive investment climate. Atala noted that the conditional cash transfer program would reach 600,000 families, and that the new government's plan also includes a "laptop for every child." A/S Fernandez asked how the USG could help with this ambitious agenda. Atala said that a new Millennium Challenge Corporation pact would be very important. Chong Wong commented that the original program had been very successful, particularly the program for small and medium enterprises, which had brought families out of poverty.

¶10. (SBU) A/S Fernandez noted that anti-corruption was another important issue for the new government to address. The economic team agreed, and Tabora noted that combating tax evasion would be another key goal. Fernandez stated that the USG would work with the new government and look further into the initiatives discussed in the meeting, and once again stressed the importance of strong Honduran engagement on Pathways to Prosperity.

¶11. (SBU) Comment: It is fortunate that A/S Fernandez was able to meet with the economic team, and in particular to highlight the importance of Pathways to Prosperity, just as the team was about to take office. Embassy staff members have discussed Pathways with the team on several occasions, beginning before the election. The team is interested in learning more but did not have time to focus on Pathways in detail during the busy transition period. Department and Embassy representatives have met in the past with civil service employees about Pathways, but this dialogue came to a halt with the June 28 coup d'etat, and those civil servants who remain are not up to date on recent developments. For Honduras to be able to engage effectively at the San Jose ministerial, the new government will need to be brought up to speed quickly. Discussions will need to be detailed and should be at the working level on the U.S. side. The Embassy has requested TDY support from WHA for this purpose and hopes that this can be arranged quickly. End comment.

¶12. (U) A/S Fernandez has cleared on this report.
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